

THE BAN ON PACKER OWNERSHIP AND FEEDING OF LIVESTOCK: LEGAL AND ECONOMIC IMPLICATIONS

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The Issue

On December 13, 2001, the United States Senate approved an amendment to the Senate Farm Bill¹ making it unlawful for a packer to own, feed, or control livestock intended for slaughter more than fourteen days prior to slaughter. The amendment includes exemptions for packing houses owned by farmer cooperatives, and packers with less than two percent of national slaughter. The amendment was approved 51-46, and became part of the Senate Farm Bill. In early 2002, the amendment language was clarified to prohibit arrangements that give packers “operational, managerial, or supervisory control over the livestock, or over the farming operation that produces the livestock, to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of the livestock.” The new language was approved 53-46 on February 12, 2002. More recently, two bills have been introduced in the House containing language comparable to the Senate version.

There has been considerable debate concerning the anticipated costs and benefits of the amendment, most of which we view as either misleading or flatly inaccurate. The purpose of this paper is to clarify the debate.

Overview

The meatpacking industry has consolidated rapidly over the last twenty years. In the 1980s and early 1990s, consolidation was primarily horizontal. In the mid-to-late 1990s, vertical integration has progressed rapidly. Packers engaged in livestock production, entered long-term contracts to secure livestock production, and purchased downstream firms for further processing. Additionally, major meatpacking firms have entered into a web of interlocking firms through joint ventures and alliances. This consolidation has led to serious concerns of an imbalance of power between meatpackers and independent producers.

Similar concerns in the late 1800s and early 1900s, led to the passage of the Sherman and Clayton Antitrust Acts and the 1921 Packers and Stockyards Act (PSA). The Congress finds itself in an analogous position today due to the structure and conduct of the contemporary

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¹ S. 1731, The Agricultural, Conservation, and Rural Enhancement Act of 2001.

meat industry.

The current debate focuses, in large part, upon efficiency versus market power. As Dr. Robert Taylor recently noted:

In the same year in which PSA was enacted, Professor Frank Knight, who some credit as the Father of the "Chicago School" of economics, cautioned against the single-minded pursuit of economic efficiency. In Knight's view, the general welfare of society depended jointly on three policy goals: (a) economic efficiency, (b) maintaining economic freedom, and (c) maintaining an acceptable balance of economic power. Moreover, he maintained that the pursuit of economic efficiency alone would be at the expense of economic freedom and a balance of economic power.²

Some past consolidations have certainly resulted in efficiency gains. However, as industry structure consolidates vertically and horizontally, efficiency gains are less likely to be passed on to either farmers or consumers.³ In the last few years, the efficiency gains are arguably negligible because economies of scale and scope can be achieved at much lower volume levels than we see today.⁴ Concerns of market power, thus, rise in importance.

The Farm to Wholesale Beef Example

An example of the macro effects that are likely caused by the increased market power of the meat packing industry can be found in the farm-to-wholesale price spreads in beef. Figure 2 illustrates the farm-to-wholesale (F-W) price spread—the difference between the price at which packers buy from producers and sell at wholesale—from January 1980 until December 2001 using USDA numbers.

In a competitive market, the F-W price spread should decrease as per-unit slaughter costs decrease. In other words, as slaughter costs decrease due to efficiency gains, a competitive market would force firms to pass those savings on to consumers. Figure 2 shows that this was indeed the case throughout the 1980s and the early 1990s.

Since the early 1990s, however, the F-W price spread has trended strongly upward. This trend is inconsistent with that which economists would expect in a competitive market. It reflects a higher gross income from packers, a fact which is confirmed by high profits being

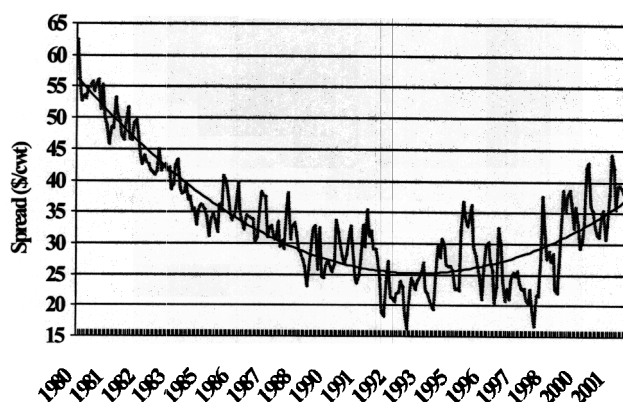
² Taylor, Robert, "Where's the Beef: Monopoly and Monopsony Power in the Beef Industry," Agriculture and Resource Policy Forum, Auburn University, March 2002.

³ It is important to note that vertical and horizontal integration benefits consumers only if any economies derived from the integration are passed on to consumers. That outcome is likely only if competition is present and competitive markets are functioning well. Instead, any efficiency gains could be passed on to shareholders or used to pad costs within the firm. In any event, the higher the level of concentration and vertical integration, the greater the risk of unacceptable market conduct.

⁴ As of 1997, the four largest firms controlled about 80% of cattle slaughter, but there were 22 plants with the highest level of production accounting for 80% of all production. Assuming these plants reflected scale economies, achieving such economies would require less than 3.7% of the market by each plant. For pork, the 31 largest plants yielded 88% of production. Again assuming that these plants reflected scale economies, achieving such economies could be reached with each plant having slightly less than 3% of the market. Consequently, a highly dispersed ownership and unconcentrated market would be consistent with the largest size of plants in both pork and beef packing. See Carstensen, Peter C., *Concentration and the Destruction of Competition in Agricultural Markets: The Case For Change in Public Policy*, 2000 Wis. L. Rev. 531, 537 (2000).

reported by the dominant firms in meat packing the past several years.

Figure 2. Farm-to-Wholesale Price Spread for Beef
USDA data adjusted for inflation



The meatpacking industry has attempted to explain this increased spread so as to not implicate market power. Those explanation are not persuasive. As Dr. Taylor notes:

A common argument made by packers to justify the increasing F-W price spread is that they are adding more value. This explanation is easily dismissed for two reasons. First, USDA Economic Research Service (ERS) calculates the spread for a standard animal so that the spread will reflect only price changes. Second, even if meat quality improves over time, there should be no long-run trend in the F-W spread for given slaughter costs.

Meat packers claim that they are realizing efficiency gains by moving to larger and larger slaughter operations. Moreover, they claim that unit slaughter costs are actually less for the leaner animals now produced. Realization of these efficiency gains in a competitive environment would result in the F-W spread continuing to trend downward, not upward as it has in the mid-to-late 1990s. Since that is not the case, the strong implication is that the meatpacking industry is less competitive.

The strong upward trend for much of the 1990s and into 2001 is simply much too strong and too persistent to be explained by short-term spikes in prices, spreads, production, or competition with other meats.⁵

Further evidence of this effect can be found in the June-July 2000 issue of Agricultural Outlook published by USDA/ERS. The USDA report stated:

“... a long-term increase would be troubling. Increasing concentration in other sectors of the economy has often reflected intense competition and frequently led to falling costs and prices for the concentrating firms. But after an industry consolidates, when few firms face each other in a stable environment, competition may often become less intense.”

⁵ See note 2 supra.

The USDA report concluded by asking the question:

"As consolidation is completed, will packers successfully limit price competition among themselves and maintain 1999's high spreads?"

We now know that the answer is "yes." The high price spreads of 1999 have not just been maintained, but they have actually trended upward in the two years since this report was published. Packers have indeed limited price competition and maintained the high F-W spreads. Thus, exertion of oligopsony power is the only plausible explanation for the strong upward trend in the F-W spread for beef.⁶

The Anatomy of Market Power in the Livestock Markets

A truly competitive market is characterized by many buyers and sellers. The economic research is clear that when the number of buyers is reduced, downward pressure on price results. Further, as marketplace volume decreases, the market is far more susceptible to intentional or unintentional actions taken by the dominant buyers.⁷

This is the case for the cash market in hogs and cattle. Both sectors have three buyers at best, and one at worst, in any given geographic procurement area. If a plant shuts down or a packer pulls out of the market for other reasons, prices suffer. Glenn Grimes, an agricultural economist with the University of Missouri, reported in March 2001 that 83% of hogs were committed to packers due to ownership or contract arrangements. This scenario leaves a very thin open market volume in which 17% of the hogs were traded in the open market. The beef industry is also trending towards thinner open market volume. A report released by USDA's Grain Inspection, Packers & Stockyards Administration on January 18, 2002, revealed that 32.3% of the annual cattle slaughter was committed to packers through ownership or contract arrangements. Twenty five percent of that captive supply number (8% of annual slaughter) was packer owned. The captive supply numbers are almost certainly higher today.

Thus, the opportunity exists for buyers to manipulate the open market due to their position as dominant buyers combined with the decreasing volume of those markets. The motive is undeniable because any exercise of market power results in decreased procurement prices for packers in both hogs and cattle.⁸

⁶ *Id.*

⁷ Concerning the impact of concentration in the hog industry, a group of Purdue University economists has stated, "We see evidence of increased concentration to the point where public vigilance is warranted. Concentration indices are high and may be reaching the point where markdown pricing on hogs will be significant and place producers at a clear disadvantage.... Two major policy options are anti-trust activity on the one hand and increasing the market power of hog producers on the other." Paarlberg, Boehlje, Foster, Doering and Tyner, "Structural Change and Market Performance in Agriculture: Critical Issues and Concerns About Concentration in the Pork Industry," Staff Paper #99-14, Purdue University, October 1999, submitted as testimony to the U.S. House of Representatives, Committee on the Judiciary, October 20, 1999.

⁸ In mid-April 2001, it was reported that a deliberate packer strategy to decrease slaughter so as to decrease beef supplies and increase packing plant cutouts and margins contributed to lower cash cattle prices. See *Feedstuffs*, Vol. 73, No. 16, Apr. 16, 2001, p.22.

Another key aspect of both the motive and opportunity to strategically affect the market through packer owned and contracted livestock supplies arises from the ability of packers to bid conservatively for livestock or to strategically pull out of the market altogether. When packers have guaranteed supplies for which they need not bid, they have far less incentive to bid aggressively for open market cattle and hogs due to the comfort margin.⁹ More significantly, packers have an incentive to schedule the processing of packer owned and contracted livestock in order to negatively affect price trends. Essentially, they have a significantly enhanced ability to pull out of the market while keeping plant capacity at one hundred percent.¹⁰

A 1996 USDA/GIPSA funded report predicted this result which we can now see through hindsight:

"What are the implications (of increased ownership and contracting) for spot markets? Terminal and auction markets for market hogs, dealers, and order buyers would decline rapidly in volume, following current trends. Spot markets for the residual supply and demand would become more thinly traded, and probably more volatile as the "shock absorber" for unanticipated changes in supply and demand. Price reporting would become more difficult, and concern about price manipulation would escalate as relatively small changes in the behavior of large market participants more likely could have an impact on reported market prices."

*"If long-term arrangements become dominant, the probable impacts would include: ... (4) less spot market volume, with associated problems of more limited market access for small producers and increased short-term price volatility for their hogs; ..."*¹¹

Former IBP chairman, Robert Peterson, addressed the strategic use of packer owned cattle before the annual convention of the Kansas Livestock Convention in 1994.

"Second, not formula cattle but packer-fed cattle, which can be killed early or late to fill a particular time frame, be it a day or a week, grant the packer far greater flexibility to move in and out of the market. On the way down [in price], he kills his cattle first and on the way up, last."

The motive for strategic behavior by dominant firms in the hog and cattle sectors is further increased by the fact that the cash market is the primary price discovery point for formula contracts and marketing agreements. Formula contracts and marketing agreements are generally tied to the cash market through some sort of formula. Thus if the cash market declines, meat packers pay less for livestock whether procured through the cash market or contract. Virginia

⁹ A significant question is whether such a practice violates the Packers and Stockyards Act (PSA). Indeed, on December 26, 2001, the Federal District Court for the Middle District of Alabama certified a nationwide class action against IBP on the legal question of whether IBP's use of captive supply violates §§192(a), (d) and (e) of the PSA. *Pickett, et. al. v. IBP, Inc., No. 96-A-1103-N, 2001 U.S. Dist. LEXIS 22453 (M.D. Ala. Dec. 26, 2001), permission to appeal denied*, (11th Cir. Mar. 5, 2002). The claim is that IBP's privately held store of livestock (via captive supply) allows IBP to need not rely on auction-price purchases in the open market for most of their supply. IBP then uses this leverage, the claim is, to depress the market prices for independent producers on the cash and forward markets in violation of the PSA. The court specifically noted that the plaintiffs had demonstrated that they possessed a "workable economic analysis" to determine the effect of captive supply on cash market prices.

¹⁰ Again, the crucial question is whether such a practice violates the PSA.

¹¹ Hayenga, Rhodes, Grimes and Lawrence, GIPSA report GIPSA-RR 96-5, May 1996, P. x.

Tech University agricultural economist Wayne Purcell is in agreement on the incentive for packers to manipulate the market to which their contracts are tied:

“Contracts with a formula arrangement where the base price is either a cash market in which the packer/processor is an active buyer or a plant average price paid for the week prior to delivery offer the wrong incentives. Whether buyers attempt to manipulate the cash market to which the contract price is tied is somewhat immaterial because the incentive to do so is present and is undeniable.”¹²

A significant number of economic studies of the issue have found that increases in supplies of livestock that are committed to the dominant packing firms through ownership or contract are correlated with lower prices in the cash market.¹³ Though some have claimed that correlation is not causation, those arguments are not credible. Further, it is important to note that the economic studies are not able to detect collusion or intent to manipulate a market because economists do not have the tools or the data for such inquiries. The strongest result is a consistent correlation between the problematic or strategic conduct and a negative result.

Lastly, evidence of how market power can be used by meat packers can be found in bidding practices. The few dominant buyers, if they buy in the same area, can develop practices that ultimately minimize competition. For example, in the Texas Panhandle region, the following particularly troubling aspects of bidding practices have been demonstrated:

- **The convention of bidding only whole dollar amounts per hundred pounds of live cattle weight.** University of California-Davis agricultural economist Richard Sexton estimated that this practice cost producers approximately \$25 million in lost revenues during the roughly 15-month period of data collection for the Panhandle study.¹⁴
- **Use of a queuing mechanism to distribute cattle to buyers, wherein the first bidder has priority in the case of tie bids.** A related problem is that the first bidder in line is given an opportunity to revise his bid in the event that someone bids higher. Thus, the key feature in securing the cattle is not to make a high bid but, rather, to secure the first bid. It need not be the buyer's "best" bid because he knows he will be able to revise it in the event that a higher bid is received. It is probably easy for buyers to agree to queuing conventions among themselves. These mechanisms, which would be difficult to maintain in a competitive environment, serve effectively to allocate the cattle among the packers.

¹² Purcell, Wayne D., “Contracts and Captive Supplies in Livestock: Why We Are Here, Implications, and Policy Issues,” report presented at the Denver Captive Supply Forum, September, 2000, and located at www.usda.gov/gipsa/forum/purcell.htm.

¹³ A report of the USDA Grain Inspection, Packers & Stockyards Administration has found that through contractual arrangements (forward contracting, marketing agreements and packer-fed cattle), packers can obtain livestock two or more weeks before slaughter. The report estimated that a 1% increase in a packer's inventory of forward contracted cattle on any given day is associated with lower prices (3 to 5 cents per hundredweight) paid for cattle in the cash market. With captive supplies running as high as 70% in some weeks, the economic impact could be as high as \$25 to \$50 per head of cattle sold. GIPSA, “Concentration in the Red Meat Packing Industry,” February 1996.

¹⁴ A similar convention by the stockbrokers who were market makers on the NASDAQ stock exchange resulted in civil antitrust penalties of more than \$1.2 billion as to those stock brokers. (*Attorney Fee Study, Class Action Reports 1999*).

Additionally, packer-to-packer trades can be a method of collusion. When packers own and raise livestock, they can sell that livestock to other packers thereby both affecting the market price and communicating that price to each other. Smithfield Foods, for example, purchased Murphy Farms and Carroll Foods. Many of the former Murphy hogs were, and continue to be, sold to IBP. This constitutes ongoing price communication between Smithfield and IBP via sales transactions that appear relatively innocent upon first observation. The proposed legislation would remove the ability of packers to manipulate the market in this manner. Other legislative remedies would be appropriate for other practices.

Unfortunately, the current enforcement regime has proved unequal to the task of promoting competition and reducing the anticompetitive of both industry structure and industry conduct. Case-law and past USDA administrative decisions have narrowed the scope of the PSA dramatically. Further, USDA's Grain Inspection, Packers & Stockyards Administration has lacked the resources and talent to effectively litigate major competition cases, or minor ones, against highly paid and experienced lawyers for the industry. In fact, USDA has not won a major competition case for at least two decades—despite the fact that USDA believed certain practices were illegal. For example, the bid queuing practice (right of first refusal) discussed above minimizes price competition. The USDA has held that such a practice does violate the PSA.¹⁵ In addition, the USDA determined that Cargill/Excell changed its premium structure for hogs in 1997 and 1998 without telling hog producers. The result was a loss to those producers of approximately \$2.9 million. The administrative law judge for USDA agreed, but refused to assess a penalty.¹⁶ While the USDA is appealing that refusal, it is clear that the deterrent factor is severely lacking.

Thus it is critical that policy makers consider legislation in light of the above-mentioned concerns.

The Packer Ownership Amendment

The final version of the amendment was approved by the Senate on February 12, 2002. The legislation amends 7 U.S.C. §192 (§202 of the Packers and Stockyards Act of 1921) by adding a new subsection (f) as follows:

¹⁵ However, on review of the USDA's decision the court reversed even though the court recognized that the right of first refusal did reduce the incentive for competitors to bid. The court reasoned that the PSA's language requires that a practice or device be *unfairly* or *unjustly* discriminatory and not merely discriminatory. The court's reasoning appears flawed inasmuch as the court, to arrive at its holding, relied on the fact that the packer paid more for the cattle at issue than it did for other cattle. Without significantly more information concerning the mechanics of the residual market, the comparison by the court appears meaningless. Thus, by having a right of first refusal and controlling the contract supply, the packer could also suppress price competition in the spot market precisely because it has a lock on the contract market. While the court claimed to recognize that the PSA prohibited the conduct at issue based on the conduct's potential to undermine competitive markets, the court actually required proof of actual harm which was not developed in the case record. Thus, the court concluded that the right of first refusal involved in the case did not potentially suppress or reduce competition sufficient to be proscribed by the Act. *IBP, Inc. v. Glickman*, 187 F.3d 974 (8th Cir. 1999).

¹⁶ *In re Excel*, No. D-99-0010 (ALJ Feb. 7, 2002).

It shall be unlawful for any packer with respect to livestock, meats, meat food products, or livestock products in unmanufactured form, or for any live poultry dealer with respect to live poultry, to:

- (f) Own, feed, or control livestock directly, through a subsidiary, or through an arrangement that gives the packer operational, managerial, or supervisory control over the livestock, or over the farming operation that produces the livestock, to such an extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock, except that this subsection shall not apply to—
 - (1) an arrangement entered into within 14 days before slaughter of the livestock by a packer, or a person that directly or indirectly controls, or is controlled by or under common control with, the packer;
 - (2) a cooperative or entity owned by a cooperative, if a majority of the ownership interest in the cooperative is held by active cooperative members that –
 - (A) own, feed, or control livestock; and
 - (B) provide the livestock to the cooperative for slaughter; or
 - (3) a packer that is owned or controlled by producers of a type of livestock, if during a calendar year the packer slaughters less than 2 percent of the head of that type of livestock slaughtered in the United States...¹⁷

This legislation, by its terms, is targeted to: (a) formal ownership by the dominant packing firms; and (b) arrangements through which packers exert management authority over the production of livestock, though nominal title remains with the producer, to the extent that the producer no longer materially participates in the management of the operation with respect to the production of livestock. Excluded are all forward contracts, marketing agreements and other non-cash sales arrangements whereby producers maintain material participation over the management of the operation. Also excluded are joint ventures and alliances, except those giving a dominant packing firm ownership or primary management control over the production of livestock. Further, farmer-owned cooperatives and small packers are excluded.

Packing Industry Claims

The claims by the meat packing industry and industry apologists have been largely misleading. We address them specifically here.

Claim #1: The legislation would make it illegal for livestock producers and packers to establish shared risk arrangements.

Response: Most captive supplies are not shared risk arrangements. Rather, they are contracts tying the delivery price to either the cash or futures market. Price risk remains with the producer and is not borne by the packer. To the minimal extent that “shared risk” arrangements

¹⁷ Amendment to S. 1371, 107th Cong. 1st Sess.

exist, they do not violate the amendment if the packer does not own the livestock or exercise management control over the production operation to the extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock. In addition, interested parties could control risk by use of hedging on the Chicago Mercantile Exchange.

Claim #2: The legislation is unwarranted

Response: As this article illustrates, packers utilize multiple mechanisms to strategically affect the market in their favor. The motive and opportunity exists for them to do so. Packer ownership of livestock is one of the tools that enables strategic scheduling to affect the cash price, and derivatively, the price of livestock procured through contracts tied to the cash market.¹⁸ The recent USDA/GIPSA captive supply report released January 18, 2002 found that 25% of captive supplies in beef are packer owned. In the hog industry, the packer owned portion in some geographic markets is extremely high while the national market share is estimated at nearly one-fourth of the total slaughter.

Claim #3: There have been no hearings and no studies of the issue.

Response: The red meat industry has been one of the most studied industries over the past century. In the 1990s, several studies from USDA have emerged on many aspects of the concentration, contracting and ownership issues. There have been several hearings in both the House and the Senate in recent years concerning concentration and competition in the livestock sector. These hearings have included packer ownership as a significant issue. In addition, a USDA field hearing was held in Denver on September 21, 2000, focusing on captive supplies and packer ownership with regard to proposed rulemaking. Further, there have been many studies of concentration, contracts and packer ownership through USDA and university sources. Packer ownership is one of the several aspects of market power that has been discussed in those studies. Most all of them have correlated increases in captive supplies, including packer owned livestock, with lower and more volatile producer prices. Economists do not have the proper tools to go beyond correlation to find collusion or intentional strategic behavior. The evidence is as strong as economists can produce. Non-agricultural literature on industry structure and conduct informs us as to the conclusion that a prohibition of packer ownership is likely to improve the competitive environment.¹⁹ Thus, a lack of hearings claim is not a persuasive reason to refrain from legislating in this area.

Claim #4: The legislation will harm packer/producer alliances and the high-value branded programs they are working together to create, and will harm competition.

¹⁸ A report of the USDA Grain Inspection, Packers & Stockyards Administration has found that through contractual arrangements (forward contracting, marketing agreements and packer-fed cattle), packers can obtain livestock two or more weeks before slaughter. The report estimated that a 1% increase in a packer's inventory of forward contracted cattle on any given day is associated with lower prices (3 to 5 cents per hundredweight) paid for cattle in the cash market. With captive supplies running as high as 70% in some weeks, the economic impact could be as high as \$25 to \$50 per head of cattle sold. GIPSA, "Concentration in the Red Meat Packing Industry," February 1996.

¹⁹ See, e.g., Scherer F.M. and Ross, *Industrial Market Structure and Economic Performance*, 3d Ed., at 522-523.

Response: Contractual arrangements and various kinds of alliances can contribute significantly to the development of efficient and competitive livestock production. The amendment in fact protects such arrangements in several ways. Importantly, the amendment leaves unaffected almost all market conduct except for arrangements whereby packers own livestock or exercise management control over the production operation to the extent that the producer is no longer materially participating in the management of the operation with respect to the production of livestock. All “alliances” are thus permitted if these two caveats are not violated. For example, a farm cooperative and a dominant firm can jointly operate a packing plant as long as the livestock is procured through a contract. The amendment also specifically permits non-dominant packing firms (that slaughter under 2% of the national slaughter) to enter into arrangements or “alliances” with producers and own livestock. Further, branded programs are unaffected if merely a supply contract is involved. There is no credible evidence that “alliances” or branded programs will be deterred in any way. In addition, large packers still would have available a full range of contractual opportunities to obtain specific types of livestock designed to meet specific needs. Moreover, such contracts could be drafted to include future delivery times and other elements that facilitate the coordination of the packer and the producer. Contracts that do not strip the producer of material participation in the management of the operation with respect to livestock production can still provide all the benefits of coordination and end-product specification that are commonly identified as desirable elements of current arrangements.

Claim #5: The legislation would have a large detrimental economic impact.

Response: On one hand the dominant firms and industry apologists claim that the percentage of supplies packers own is insignificant.²⁰ On the other hand, they argue that a huge negative economic impact will result. The argument that the amendment threatens investment in quality control and market development has little basis in fact. Investment in quality control as to live animals has occurred consistently for years through education by universities, checkoff programs, third party agri-advisory services and packers. Investment in market development has also occurred uninterrupted for years through the same sources. All parties—universities, checkoff programs, third party agri-advisory services and packers—claim credit for any gains therefrom. There is no evidence that packer ownership of livestock is either the best or even a necessary method to achieve any such gains that may or may not be proved. Indeed, the prohibition of actual packer ownership of livestock does not raise any significant efficiency or competition concerns.

Claim #6: The legislation would force the divestiture of some of the largest cattle feeding businesses.

Response: The amendment is written to provide a divestiture period that is as generous, or more generous, than large divestitures arising under antitrust law in other sectors. Packers

²⁰ See, e.g., Meyer, Mintert, Peel, Plain and Robb, *Prohibition on Beef Packer Ownership, Feeding and Control of Cattle: Comments and Discussion*, January 18, 2002.

have six months to divest cattle and sheep and eighteen months to divest swine. Most antitrust divestitures provide for six months. For example, the divestiture resulting from the 1998 Cargill-Continental Grain settlement with the Department of Justice provided for six months to divest several large river, rail and port facilities for grain handling and storage.

The divestiture period in the amendment allows an orderly exit from the feeding business. Because cattle require a maximum of six months to feed from feeder cattle weight to slaughter weight, packers will merely consume their own product during the divestiture period while refraining from restocking. The same is true for hogs which require five to six months from birth to slaughter. There is a tremendous economic disincentive for packers to sell cattle or hogs that are not at slaughter weight. The values of those animals prior to slaughter weight are very low.

With regard to predicted drops in feeder cattle prices, those claims fail to take into account: (1) new entrants to the feeder cattle market who would bid to fill slaughter demand; and (2) the fact that feeder prices are tied to breakevens resulting from the cash slaughter market. In other words, packer slaughter capacity will not change as a result of the amendment. If packers do not own the cattle to be slaughtered, others will bid for the feeder cattle to fill the void. Because feeder prices are determined from predicted breakeven analyses derived from the steer and heifer market, it is unreasonable to assume that a drop in the feeder cattle market would arise or persist.

Claim #7: The legislation would harm cattle feeders in regions served by fewer packing plants.

Response: There is no credible evidence to support this theory. Packing plants could, via contract, ensure a supply of livestock. Ownership interests are simply not the only (or even the best) way to obtain longer-run supplies and develop the upstream supply market. In addition, if the plant is small (less than 2 percent of the national slaughter), the amendment does not apply, so a new entrant could use ownership as part of its entry strategy if such a strategy is deemed essential. As to existing plants, a significant question is why they would seek to tie up supply. One effect of such behavior is to make competing entry more difficult. Such plants may actually be engaged in exclusionary behavior by exploiting a low-volume market where there is little or no competition, but if entry by other firms occurred, they would have to pay market prices. Moreover, if a plant is badly managed and does not make proper provision for supplies, it may fail, but its assets will be available for another owner who can make better use of the assets.

Claim #8: The required divestiture in the pork industry would have an even more severe economic impact.

Response: Again, the industry claims that the volume of packer owned livestock is insignificant at the same time assertions of drastic harm arise. Hog slaughtering companies have been extremely profitable over the past few years. For example, Smithfield Foods reports in its 2001 Annual Report that it has averaged 28% profit over the last two decades. Producers have not been so fortunate. Additionally, the divestiture period for hogs is quite generous. The eighteen-month period is three times as long as the six-month period of time traditionally allowed in antitrust divestiture cases. Dominant hog packing firms will have both the incentive and the time to maximize the return in the open market on their facilities. Again, the important

point is that once the ban is in place, firms subjected to the ban will have sufficient time to adjust business strategy.

Claim #9: The export impact is severe

Response: There is no credible evidence linking packer ownership to export successes. The dominant economic factors in exports are monetary policy (strong or weak dollar), subsidies, tariffs, and the quality of private company marketing staff.

Claim # 10: The legislation will accelerate the move of the U.S. industry to our Canadian and Mexican neighbors.

Response: Nebraska,²¹ Iowa²² and South Dakota²³ have some form of packer feeding prohibition. Yet these states have maintained their packing capacity. Stated another way, those state packer feeding prohibitions have not negatively affected the livestock sector in a manner that differs from states without such prohibitions. That is because the dominant factors in plant location are the availability and price of feed grains, and the availability of livestock.

Also, the Tariff Rate Quotas (TRQ) currently in effect for imports are prohibitive. The current TRQ for beef is 700,000 tons, most of which is filled by Argentina and New Zealand. The “fill rate” on this TRQ is 630,000 tons. That means that any new beef imports coming into the U.S. will have a very high tariff applied, once the TRQ limit is reached.

Additionally, Mexico is a grain deficit country lacking the feed sources to ramp up production. Also, the traditional breeds of cattle that American consumers prefer to eat cannot survive and thrive in the hot climate of Mexico. Quality would be significantly affected by a shift to other countries. Lastly, the USDA Food Safety Inspection Service is coming under increasing political and citizen pressure for allowing imports of meat from foreign slaughter plants due to recent reports of unsanitary conditions.²⁴

Clearly, the competitive advantage for cattle remains in the U.S. due to basic and fundamental economic factors. The risks and uncertainty arising from shifting plant production to other countries is immense. If the shift occurred, more opportunities for new entrants to the domestic slaughter industry, or growing small firms, would be undeniable.

Claim #11: The legislation increases the competitive advantage of poultry.

Response: There is little or no evidence of prospective harm to the red meat industry in relation to poultry. However, it is important to note that neutrality is often not the goal of legislation of any type when responding to public interest concerns. In any event, many of the

²¹ Neb. Rev. Stat. §54-2602 prohibits direct or indirect packer ownership of livestock more than five days before slaughter, and has not been held applicable to any type of marketing agreement.

²² Iowa Code §9H.2 prohibits any processor of beef or pork from owning, controlling or operating a feedlot in Iowa in which hogs or cattle are fed for slaughter. The legislation, however, does not prevent a processor from contracting for the purchase of hogs or cattle.

²³ The South Dakota provision is contained in the state constitution as a 1998 amendment prohibiting non-family farm corporate ownership of land or livestock. S.D. Const. Art. XVII, §§21-24.

²⁴ Relatedly, the Senate-passed farm bill contains a country-of-origin labeling provision primarily in response to such concerns.

dominant meat packing firms also have significant poultry interests. Thus, any competitive advantage for poultry among the firms in the industry will be significantly minimized or negated. For instance, in terms of share of the market, Tyson is number one in beef, number two in pork and number one in broilers. ConAgra is number two in beef, number three in pork and number four in broilers. Cargill is presently ranked third in beef, fourth in pork and third in turkeys. Also, Hormel owns Jenny-O Turkeys, the number one firm in turkeys.²⁵

Concerning the argument that the legislation will cause harm to beef and pork producers if beef and pork lose ground to poultry, econometric studies have documented only limited substitution between beef/pork and poultry. Thus, any adverse efficiency effects caused by the legislation will be either nonexistent or not of sufficient degree to cause wholesale consumer substitution from beef/pork to poultry.

Claim #12: A loss of animal feeding operations yields a corresponding loss of markets for grain production.

Response: There is no evidence that a net loss in animal feeding operations will occur. There is every reason to believe that production by non-packers will fill any void left by the “insignificant” volume of livestock that the packing industry divests over either a six-month (for cattle) or eighteen-month (for hogs) period.

Conclusion

The packer ownership amendment addresses real problems in the competitive environment of the livestock industry. The claimed harms arising from the amendment are largely not credible, and certainly less significant than the potential benefit to the marketplace. If any negative market effects occur, such effects will be the result of packers using their tremendous power over the marketplace. The economic fundamentals, apart from strategic behavior, do not warrant such dire claims. In addition, irrespective of the merits of the economic argument that contracting and alliances in livestock production are essential to efficiency and competition, the ban on packer ownership will not bar producers and packers from entering into such agreements.

²⁵ Hendrickson, Mary and William Heffernan, *Concentration of Agricultural Markets*, February 2002 Report for the National Farmers Union, www.nfu.org/documents/01_02_Concentration_report.pdf.